

EMERGING MARKETS WEEKLY PERSPECTIVE

February 17, 2010

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Global Economic Research

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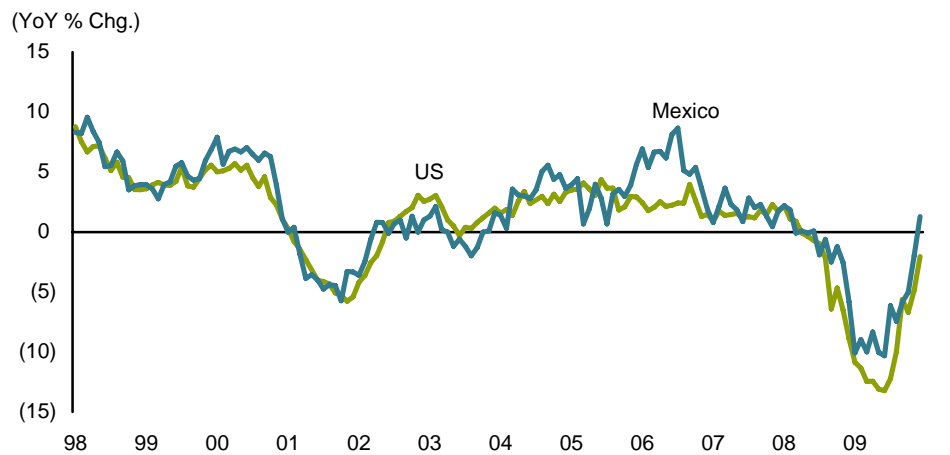
	Moody's / S&P ¹ Rating	Expected Rating Trend	Foreign Currency Debt Rating
LATIN AMERICA ¹ (POS) = Pos Outlook; (NEG) = Neg Outlook			
Argentina	B3 / B-	↔	Market Weight
Brazil	Baa3(POS) / BBB-	↑	Overweight
Chile	A1(POS) / A+	↑	Market Weight
Colombia	Ba1 / BBB-	↔	Market Weight
Costa Rica	Ba1(POS) / BB+	↔	Market Weight
Dominican Republic	B2 / B	↑	Overweight
Ecuador	Caa3 / CCC+	↔	Market Weight
El Salvador	Ba1(NEG) / BB	↓	Overweight
Jamaica	Caa1 / SD	↑	Overweight
Mexico	Baa1 / BBB	↓	Underweight
Panama	Ba1*+ / BB+(POS)	↔	Market Weight
Peru	Baa3 / BBB-	↔	Market Weight
Uruguay	Ba3 / BB	↑	Market Weight
Venezuela	B2 / BB-	↔	Overweight
ASIA			
China	A1(POS) / A+	↑	Market Weight
India	Baa2 / BBB-(NEG)	↔	Market Weight
Indonesia	Ba3 / BB-(POS)	↑	Overweight
Korea	A2 / A	↔	Market Weight
Malaysia	A3 / A-	↔	Market Weight
Pakistan	B3 / B-	↔	Underweight
Philippines	B1 / BB-	↔	Market Weight
Sri Lanka	NR / B(POS)	↑	Market Weight
Vietnam	Ba3(NEG) / BB(NEG)	↓	Market Weight
EMERGING EUROPE, MIDDLE EAST & AFRICA (EEMEA)			
Bulgaria	Baa3(POS) / BBB	↓	Market Weight
Egypt	Ba1 / BB+	↔	Market Weight
Gabon	NR / BB-	↔	Market Weight
Georgia	NR / B	↔	Market Weight
Ghana	NR / B+(NEG)	↔	Market Weight
Hungary	Baa1(NEG) / BBB-	↔	Market Weight
Kazakhstan	Baa1(NEG) / BBB-	↔	Overweight
Lebanon	B2(POS) / B(POS)	↑	Underweight
Lithuania	Baa1(NEG) / BBB	↔	Overweight
Poland	A2 / A-	↔	Market Weight
Russia	Baa1 / BBB	↔	Overweight
Serbia	NR / BB-(NEG)	↑	Market Weight
South Africa	A3 / BBB+(NEG)	↔	Market Weight
Tunisia	Baa2 / BBB	↔	Market Weight
Turkey	Ba2 / BB-	↔	Underweight
Ukraine	B2(NEG) / CCC+	↔	Overweight

Argentina—Growing Ever More Cautious. We have written a lot in the past two weeks about how flat-lining reserves in both Argentina and Brazil, both of whom report daily movements, probably herald a more risk-sensitive market. In the case of Argentina, that outlook needs to be underscored. The country is even more dependent upon robust liquidity, capital flows, and risk appetite since it has no relations with the IMF, no market access, and a policy mix that does not give confidence to investors. The steady reserve numbers have continued through the end of last week. But we can now add on a weak peso, which has declined in value about 1.5% in the past month. The sliding peso, along with all the other factors, is likely to inspire local Argentines to on the margins change their bank deposits from pesos to dollars. The central bank will be left with a choice of using reserves to steady the currency, or letting the currency slide. They will likely choose the latter, which will only exacerbate a tendency to shift the deposit composition. It is easy to see how this can begin to gain momentum in sliding downhill. We think this risk justifies reducing further our exposure in the country.

Venezuela's Medium-Term Oil Outlook Less Cloudy. Last week the government managed to auction two of three blocks of the heavy crude Orinoco Belt fields. Some observers cited the delays in the auction, and the fact that one field was left un-auctioned, as proof that the government continues to struggle, with ideology reining over competence. However, one of the winners was a consortium headed by Chevron, and we think that Chavez is grudgingly coming around to the idea that the only way to secure the future of Venezuela is development of these fields with some urgency. That means, in this one limited arena, setting aside the ideological purity, at least temporarily. Oil could begin to flow as soon as 2013, and we are sure that Chavez firmly believes he will still be running the show at that time.

Mexico Recovering in Lock-Step Mexico's December industrial production released last week showed a 1% gain over the prior month, moving the year-over-year comparison to positive territory (1.3%) for the first time since April of 2008. While we have no doubt that the economy is recovering, the data is a reminder on how closely the Mexican economy is still tied to the US. The correlation between industrial production in the two countries is 90%. The fact that Mexico's IP recovery seems to be proceeding a bit faster than that of the US makes us believe that it is likely either the pace of Mexico's recovery cools or that of the US picks up, since extended periods of divergence are quite rare.

Display: Mexico Still a US-Dependent Story



Source: Instituto Nacional de Estadística Geografía e Informática, Federal Reserve Board and Haver Analytics

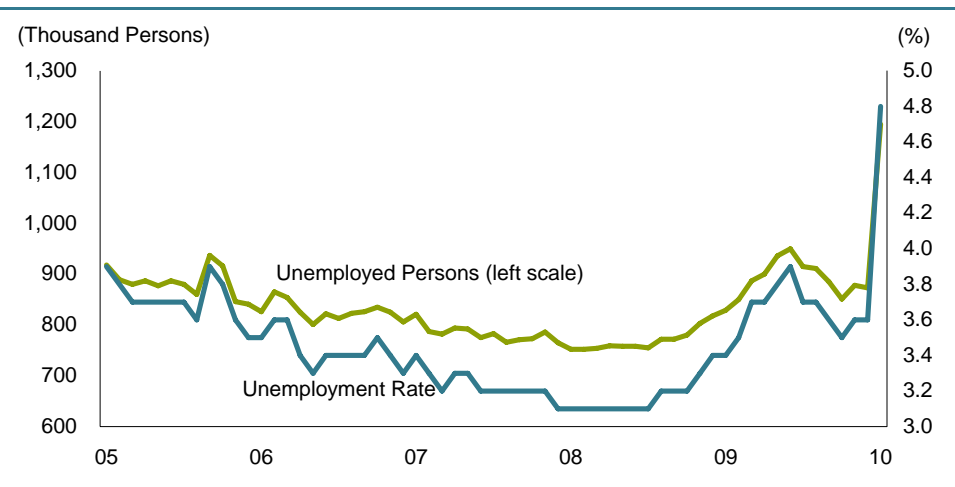
China's Second RRR hike. The People's Bank of China raised banks' reserve requirement ratio (RRR) for the second time by 50bp (to 16.5% for large banks and 14.5% for small banks) followed January's 50bp hike. The direction of the move was certainly in line, but timing was slightly earlier than thought. Instead of a wildly anticipated post-Lunar New Year hike, the authority had decided to raise it just before the week-long spring holiday started on February 12. This, once again, has surprised the market with its preemptive move.

Last week's RRR hike will mop up about RMB250-300 billion liquidity from the banking system, and reflects the effort to curb local banks' ability to lend in response to the release of another outsized RMB1.39 trillion new loans in January. This is part of China's quantitative money controls to achieve this year's new loan target of MB7.5 trillion.

In 2007-08 when China suffered badly from rampant speculative inflows, the central bank was forced to hike RRR by a total of 800bp during the period. Absence of the influx of hot money, we think a total of RRR hike of 250-300bp should be a reasonable forecast for this year (so another 150-200 more to go). We also think that an official lending rate hike will come soon, likely to occur in March or early 2Q the latest. Overall, the latest move shows that Beijing's monetary tightening is under good control.

Korea's Interest-Rate Outlook. As widely expected, the Bank of Korea left overnight rate unchanged at 2% last week. Renewed global uncertainty, plus the massive jump in January's unemployment rate (seasonally adjusted) to 4.8% (from 3.6% in December, see **Display**) are headwinds to our call that Governor Lee will hike in March before he leaves the job in April. While the massive jump in unemployment rate is politically negative, the reason behind January's drastic move was largely technical in nature and reflected more discouraged workers retuning to job market due to improved economic prospects. As such, the underlying trend in the labor market should be viewed positively as well as a longer-term pro-tightening factor.

Display: A Sudden Jump
Korea's Unemployment (seasonally adjusted)



Source: CEIC Data

Ukraine: Slowdown in Q4 GDP Likely to Be Temporary. Based on reported year-over-year data, we estimate that real GDP was essentially flat in Q4 at -0.2% q/q sa, following two quarters of strong sequential growth of 4.6% in Q2 and 1.7% in Q3. This growth drove the year-over-year improvement in Q4 to -7.0% from -15.9% in Q3. While details are not yet available, the ongoing improvements in industrial production and exports suggest that export-oriented industries continue to grow, while the tighter fiscal policy in Q4 and ongoing credit contraction are curtailing domestic demand. Going forward, we expect the reengagement of the IMF, more moderate fiscal policy and recovery in global growth to lead to modest growth in Ukraine in 2010. The completion of the second round presidential elections is likely to improve the economic policy framework as the winner consolidates decision making authority in parliament. Parliament has scheduled Yanukovich's inauguration for February 25, and we do not expect the constitutional court to approve Timoshenko's appeal for a re-run second round vote.

Turkey: Central Bank Holds Rates As Expected. The central bank kept rates on hold at 6.50% for the third month in a row as expected. The most notable change in the central bank's statement is that it now expects core inflation, in addition to headline inflation, to rise through mid-year. It argues that core inflation will remain within the target range and that the increase will likely be temporary due to the negative output gap. While the market has so far been unwilling to bet against the central bank, at some point this is likely to change since a continued rise in inflation expectations and stronger-than-expected recovery in growth go against the central bank's view. Moreover, the central keeps changing its focus. The decline in headline and core inflation last year because of tax hikes and declining energy prices justified rate cuts, but now the reverse of these pressures does not justify hikes.

Hungary: Pace of Economic Contraction Slows in Q4. Real GDP contracted by -0.4% q/q sa in Q4, which is close to our estimate of -0.2%. The contraction is an improvement from the previous five quarters, when real GDP contracted by 1% to 2% per quarter. Overall for 2009, real GDP contracted to -6.9% versus our forecast of -6.8%. Details are not available, but high frequency data suggest that industrial production remained positive, while domestically oriented sectors continued to contract. Our sequential forecast calls for growth in each of the four quarters of 2010, driven by export demand and restocking.

South Africa: Market-Friendly Fiscal and Monetary Policy Announcements. The finance minister announced a series of market-friendly measures this week. First, the proposed budget for fiscal 2010/11 seeks to reduce the fiscal deficit to 6.2% of GDP, which is slightly below the 6.5% expected and down from 7.6% in 2009/10. The budget is based on reasonable assumptions. Second, he said that while South Africa needs a competitive exchange rate, capital inflows help South Africa's investment and a fixed exchange rate is not realistic in today's world. The government would continue to "lean against the wind" by accumulating reserves to manage capital inflows, but exchange controls are not on the table. This represents a welcome continuation in policy. Third, he said that the debate over the central bank's mandate and inflation target range will continue within the government. However, it does not appear that the government is prepared to take any radical action. In our view, an expansion of the central bank's mandate to include growth and employment would not detract from the goal of price stability. And the government may still widen the 3% to 6% inflation target range, but a new range is unlikely to exceed the previous 7% ceiling.